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SUBJECT: IMPLICATIONS OF FSA BUDGET REDUCTION FOR AZERBAIJAN

¶1. (U) As we have started to implement our FY08 assistance programs, we are beginning to appreciate in very real terms the magnitude of the FY08 budget cuts. The 40 percent reduction in our FSA budget in a single year will have a serious impact on our ability to advance our political and economic agenda supporting western-oriented democratic development and advancing U.S. interests in freedom and stability in Azerbaijan. The 40 percent reduction will mean slashing successful programs that are just beginning to achieve important results, many launched only in 2002 with the waiver of Section 907. This is a decade late, relative to some of our efforts in other former Soviet republics. Democratic reform remains a major challenge and requires sustained effort here. Ten months from a presidential election, press freedoms and freedom of assembly remain constrained. Corruption threatens the significant gains of Azerbaijan's vast oil wealth. Azerbaijan is beginning to see signs of religious extremism which, if fueled by continued poverty and corruption, increased inflation, and lack of political openness, could flare over time.

¶2. (U) We have no illusions about returning to FY07 funding levels. However, we feel compelled to document the expected impact of these cuts, to inform discussions about next year's funding levels. Moreover, as we have discussed in the 2008 Elections Assistance Strategy, we have identified key activities where we can use performance funds to leverage reform in the critical areas of freedom of assembly, freedom of the media, and rule of law in the run up to the 2008 Presidential election.

¶3. (SBU) We recognize the logic of OMB and others that focuses assistance budget cuts on countries that have significant non-assistance income potential. Azerbaijan, however, is not yet at the point at which it will on its own strongly promote a Western-oriented reform agenda, particularly in the critical areas of building strong democratic institutions, fighting corruption, breaking up monopolies and opening the economy to competition. International assistance to spur and support reform remains key to bolster nascent efforts to build democratic institutions and strengthen democratic forces here. The majority of our assistance programs began only after the waiver of Section 907 in 2002. They are only now beginning to show results. Dramatic cuts to USG assistance to Azerbaijan at this time work contrary to U.S. interests in pushing for urgently needed reform. In the long-run, they can be costly to our broader interest in promoting stability and economic and political development in a highly strategic country.

¶4. (U) USAID's Civil Society and Community Development projects and INL's law enforcement and judiciary support programs have been the hardest hit of our assistance programs

this year. This year's cuts were particularly difficult to prioritize as they were so large. We chose to cut areas in which we hoped our activities could continue, albeit at a reduced level of effectiveness. We also chose to cut entirely some projects where it was no longer efficient to maintain the infrastructure for small projects. We are particularly concerned that we had to slash civil society, economic growth and agriculture programs, but this year's funding reductions were so large that only cuts in these more costly programs would allow us to balance our budget. This year's reduction also is creating an imbalance in our assistance levels (DTRO, EXBS, ODC, and DoE programs) now easily surpass what we are spending on economic and political reform. Below are a few examples of the programs we are being forced to scale back or eliminate:

-- We will be reducing our civil society support program by 60 percent. Down from a previous annual funding level of roughly \$6.3 million, the FY08 budget of \$2.5 million will significantly reduce our ability to strengthen civil society and carry-out critical community development and consensus building activities in vast regions of the country long-ignored by the government and the international donor community. USAID's five-year Civil Society Project made significant progress during its first two years by achieving a nation-wide framework for citizen participation with buy-in from 250 leaders from national and local government, businesses, and civil society organizations. Advocacy will be hit particularly hard, reducing available funding for grassroots advocacy campaigns from the planned 54 organizations to only 18 organizations. These budget cuts reduce total annual funding available for NGO technical assistance and training from 400 NGOs to only 30 NGOs, severely hampering project outreach in poor rural and semi-urban areas. At the same time, these programs represent an investment in the longer-term success of political development in Azerbaijan -- laying the foundation for an empowered, educated and engaged citizenry, key to effective democracy.

-- Our Community Development Activity has broad outreach in 14 regions in Azerbaijan and works at the grassroots level with 90 communities to build citizen participation and increase cooperation between citizens and government. Great strides have been made in two years: thousands of people have made significant contributions of cash and labor (\$700,000 est.) to share the expense of over 180 community projects; communities are appealing to local government authorities for assistance (\$70,400 in municipal contributions have been provided thus far); municipalities are conducting open hearings on local budgets for the first time ever (80 municipalities published budgets and are conducting hearings); and citizens from these communities are addressing their concerns to Parliamentarians. These programs, as well, strengthen the foundations for successful longer-term democratic development.

-- Funding for the Community Connections program, which supports study tours for groups of selected public and private sector representatives to the U.S., will be eliminated in its entirety. The program has been important in terms of acquainting Azerbaijani Muslims with U.S. culture and religious freedom.

-- One of the hardest hit areas of our FY08 budget has been our funding for reforms in the critical areas of law enforcement and the judiciary. We expect a minimum of \$790,000 to be cut from this already modest program. While just barely allowing us to keep our legal advisor and law enforcement advisor, it draws down to zero our ability to fund complementary training and education activities for judges and police officials. These nascent programs have already shown results in terms of judicial examinations and selection and shaping police training. The absence of a modern, independent legal and judicial system is a key impediment to Azerbaijan's political development.

-- In addition, the reduced funding will limit the scope of

USAID Economic Growth Programs, particularly in the area of fiscal reform. This will inhibit our capacity to help Azerbaijan avoid the worst aspects of the oil curse. Funding for agriculture, originally budgeted at \$400,000, will be eliminated in its entirety, as well as \$500,000 in funding supporting workforce development - a critical human capacity building activity.

15. (SBU) Finally, with your help, we have involved the GOAJ in a promising, if difficult, discussion on co-financing. As you know, the GOAJ has long participated through cost sharing, but co-financing represents a new approach. While co-financing may boost our economic reform programs, we do not anticipate GOAJ co-financing in the democracy and governance sector, although we have requested GOAJ co-financing to support our Civil Society and Community Development projects.

16. (U) We welcome the support of EUR/ACE as we undertake these dramatic cuts, both in terms of guidance about preserving the best of our programming, but also in terms of supporting our request for supplemental funding to address ongoing policy priorities, such as media freedom and the upcoming elections. We also urge that Washington consider the key role that USG assistance plays in supporting democratic reform in Azerbaijan, both political and economic, as FY09 funding decisions are made. It is difficult to argue that we stand strongly behind continued reform and democratic development, both economic and political, in Azerbaijan, when our concrete support has been reduced so significantly.

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